

CAUTIOUS CREDITOR®

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REVISED ARTICLE 9 IMPACTS REAL ESTATE TRANSACTIONS

Recent issues of the *Cautious Creditor*® addressed various aspects of Revised Article 9 of the Uniform Commercial Code (UCC), which will take effect in Indiana on July 1, 2001. This issue of the *Cautious Creditor*® addresses the effect of Revised Article 9 upon real estate transactions and foreclosure of real estate-related security interests (other than agricultural liens and security interests in farm products, which will be addressed in a future issue of the *Cautious Creditor*®).

Coverage of Real Estate-Related Collateral

In general UCC Article 9 applies only to security interests in personal property and fixtures, not liens on real property. Revised Article 9 continues to respect this distinction, with a few notable exceptions. The most significant real estate-related changes include extension of Article 9's coverage to encompass not only security interests in promissory notes and payment obligations secured by real property, but also outright transfers of promissory notes and other payment obligations that are secured by real estate mortgages.

Revised Article 9 provides that a security interest in a promissory note or other payment obligation secured by real estate is perfected by filing a financing statement, whereas current law requires the secured party to take possession of the instrument. Since security interests in promissory notes and other payment obligations can be perfected by filing, the safe practice will be to file in all cases to protect the interest from attack by a bankruptcy trustee. In order to protect the security interest against a later buyer or secured creditor who gives value and takes possession of an instrument in good faith and without knowledge that the purchase or lien violates the rights of the original buyer or secured party, it is still necessary to perfect the interest by possession. Revised Article 9 also treats

sales of promissory notes or other payment obligations the same as security interests in notes or obligations.

Revised Article 9 resolves the question under current law of whether perfection of a security interest in a promissory note or other obligation also perfects the secured party's rights in the underlying mortgage that secures the payment obligation. Consistent with the rule that the mortgage follows the note, Revised Article 9 provides that attachment of the security interest in the promissory note or other payment obligation automatically causes the security interest to attach to the "supporting obligation," such as the mortgage. It is not necessary for the buyer or secured creditor to record a mortgage in the real property records in order to perfect its interest in the mortgage, because the perfection of the security interest in the obligation automatically perfects the security interest in the supporting obligation. However failure to record the assignment in the real property records may expose the secured creditor to the risk that the original mortgagee may record a fraudulent deed of release, which a bona fide purchaser could rely upon to take free of the mortgage.

Although Revised Article 9 generally continues the current law's provisions regarding minerals, oil and gas, timber, fixtures and manufactured homes, several changes are noteworthy. The Revised Act creates a new defined category: "as-extracted collateral." Unlike most other types of collateral, which will be perfected by filing a financing statement in the state of the debtor's location, financing statements covering as-extracted collateral must be filed in the state where the wellhead or minehead is located. Furthermore, instead of filing in the otherwise proper state office, these financing statements must be filed in the office where a mortgage on the related real property would be filed.

Revised Article 9 provides that the instant standing timber is cut, a financing statement previously filed in the office where a mortgage on the related real property would be filed no longer secures the collateral, and a financing statement must be filed in the state office in the state of the debtor's location, which may be a different state.

The Revised Act generally continues the current law as to treatment of fixtures and makes no attempt to define "fixtures," deferring to local real property law to determine whether the goods have become sufficiently related to real property to be considered fixtures. Like current law, a security interest in fixtures may be perfected by filing a financing statement in the office where a mortgage on the related real property would be filed. Revised Article 9 generally continues the existing priority rules for fixture filings, except that the 10-day grace period to perfect a purchase money security interest in fixtures has been extended to 20 days from the date the goods become fixtures.

The new act provides special rules for "manufactured homes," even when erected on a permanent foundation. If a security interest in a manufactured home not held as inventory is perfected under a relevant certificate of title statute, it generally has priority over a conflicting interest in the real property, even though no fixture filing was made. Furthermore a financing statement covering a security interest in a manufactured home can be made effective for 30 years, instead of the usual five years.

Foreclosure of Real Estate-Related Security Interests

In cases where the security agreement covers both personal property and real property, Revised Article 9 provides the creditor with the choice of proceeding against the personal property under Article 9 or under real property law. The secured creditor may foreclose against both the real and personal property under real property law without being subject to the UCC foreclosure rules, or may proceed against the personal property under the Article 9 rules without prejudicing its rights with respect to the real estate. Upon default, a secured party holding a security interest in an obligation secured by a real property mortgage has the right to enforce the mortgage. Revised Article

9 gives the secured party the power to become the assignee of record by recording the security agreement and an affidavit certifying default, resolving problems under prior law where the original mortgagee is unwilling to sign a recordable assignment.

Comment

A common complaint about existing UCC Article 9 is that the distinctions between treatment of real estate collateral and personal property collateral are confusing. The Revised Article 9 drafting committee devoted considerable attention to this problem and sought to expand the application of Article 9 to transactions involving real property collateral and eliminate deterrents to use of Article 9 foreclosure and sale remedies in real estate defaults. Nevertheless the line between real property and personal property is not a precise one, and the application of UCC Article 9 to secured transactions involving real estate collateral will continue to be difficult. As in the past, the *Cautious Creditor*® will continue to monitor developments in this complex area.

For more information in this area, please contact Henry A. Efroymson at (317) 236-2397, Internet: efroymso@icemiller.com.

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